IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-648

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

versus

PENNZOIL PRODUCING COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE AMICI CURIAE,
WILLIAMS, INC., ET AL.

CAMPBELL C. HUTCHINSON
ANTHONY M. DiLEO
Stone, Pigman, Walther,
Wittmann & Hutchinson
1000 Whitney Bank Building
New Orleans, Louisiana 70130
Attorneys for Amici Curiae

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BRIEF OF WILLIAMS, INC., ET AL.
AS AMICI CURIAE*

INTEREST OF AMICI CURIAE

Amici are Williams, Inc. and the individual royalty owners[1] (hereinafter collectively referred to as

* This brief is submitted by Williams, Inc., *et al.*, as *amici curiae*, with the consent of all parties pursuant to Rule 42 of the Court.

1 Frank B. Williams, Elizabeth Williams, Ann J. Marsak, Alec Andrew Johnson, Succession of Mrs. Delphine L. Williams, The Kemper and Leila Williams Foundation, Katherine W. Tremaine, Elizabeth C. Brooks, Marie L. Campbell, Allan A. Campbell, Barbara A. Campbell, Holbrook Campbell, Jr., Whitney L. Campbell, Trustee, Elizabeth Williams Trust, Lucille W. Mayfield Trust for Alec A. Johnson, Phoebe Williams Ellis, and Whitney National Bank of New Orleans, Trustee.

"Williams") who are parties to the settlement agreement with Pennzoil Producing Company (Pennzoil) and Shell Oil Company (Shell) that is the subject matter of this case. Because the settlement shall take effect only upon approval by the Federal Energy Regulatory Commission (Commission) of one of the two alternative procedures set forth in the settlement agreement, *amici* are directly affected by the outcome of this case.

In 1934 Williams, Inc. (then F. B. Williams Cypress Company, Limited) entered into a Mineral Lease with Shell (then Shell Petroleum Corporation) covering substantial acreage owned by Williams, Inc. in South Louisiana. Included under the 1934 lease was a block of acreage in Terrebonne Parish, Louisiana that subsequently became an oil and gas field known as Gibson Field. In 1942 Shell subleased to Pennzoil (then Union Producing Company) its rights in the gas and certain other hydrocarbons to be produced under the 1934 lease. In 1952 Shell acquired a lease from Williams covering a twenty-acre tract within Gibson Field.

The 1934 lease requires the lessee to pay gas royalties on the basis of one-eighth of the *value* thereof, calculated at the *market rate* prevailing at the wellhead. The royalty clause in the 1952 lease is substantially the same, except that the fraction is one-fourth rather than one-eighth. Beginning in 1972 the landowners adjacent to Williams began receiving gas royalties on a considerably higher basis per Mcf than Pennzoil and Shell were paying to Williams. Demands were made by Williams on Pennzoil and Shell to in-

crease royalty payments to reflect actual market value of the gas being produced from Gibson Field. Pennzoil and Shell responded by asserting that they were paying gas royalties on the basis of a percentage of proceeds received by them under gas sales contracts with United Gas Pipe Line Co. (United) and that such payments satisfied their obligations under the leases.

The parties were unable to resolve their differences, and in March 1974 Williams made formal demand on the lessees, in accordance with the leases, to make up the deficiencies or suffer cancellation of the leases. Shell and Pennzoil then immediately brought an action for an injunction and declaratory judgment in the Civil District Court for the Parish of Orleans, Louisiana[2] (hereinafter "the state court litigation"), and Williams responded by asserting a counterclaim for cancellation of the leases and damages for the underpayment of royalties.

After extensive discovery in the state court litigation, Pennzoil, Shell and Williams entered into a settlement agreement on June 18, 1975, which provided for a compromise of the Williams' demands, subject to approval by the Commission either to permit Pennzoil and Shell to pass to United through the increased royalty cost resulting from the settlement, or to permit the lessees to abandon in kind the fractional royalty interest to Williams for sale in the intrastate market. As a condition of the settlement, the state court litigation was stayed pending the proceedings before the Commission. Because of the delays in-

2 *Shell Oil Co. and Pennzoil Producing Co. v. Williams, Inc., et al.*, Docket No. 573-591 (May 24, 1974).

curred in the proceeding before the Commission, the stay of the state court proceeding has been lifted,[3] and the parties have engaged in further discovery.

Amici join Pennzoil and Shell in urging this Court to affirm the decision of the Court of Appeals for the Fifth Circuit. If the Commission does not approve the relief requested, Williams will certainly continue with the state court litigation. Therefore, Pennzoil and Shell are in the uncomfortable position of not being able candidly to assert to this Court the full extent of their perilous condition in the state court litigation for fear of the effect of their statements on that litigation. Williams, however, is not so constrained.

ARGUMENT

Williams, as *amici curiae*, will not attempt to respond to each argument raised by the Commission, leaving that task to Pennzoil and Shell. We will address ourselves to the two major objections of the Commission, namely, (1) the relationship between the royalty costs incurred by Pennzoil and Shell under the settlement and the "unregulated market," and (2) the reasonableness of the settlement.[4]

---

3 The settlement agreement provided that either the plaintiffs or the defendants could terminate the settlement if the Commission refused or failed to issue the necessary authorization by February 1, 1976. On February 6, 1976 the parties to the state court proceeding filed a joint motion to vacate the stay order, without terminating the settlement agreement.

4 The reasonableness of the settlement was not an issue in the Court of Appeals because the Commission below had determined that it lacked authority to permit relief under any circumstances, though the Commission expressed sympathy for the plight of Shell and Pennzoil. *The reasonableness of the settlement is raised here by the Commission for the first time in any judicial forum.*

I. Royalty Costs Resulting From The Settlement Are Not Based On Or Tied To The Unregulated Intrastate Market For Natural Gas, But Are Tied To The National Rate Set By The Commission.

The Commission has erroneously characterized the basic issue presented by this case, and its primary argument is based on the same misconception. The Commission states that the first question presented is "[w]hether the Natural Gas Act permits the Commission to establish rates for the interstate sale of natural gas that pass through to interstate consumers *royalty costs based on the unregulated price of natural gas in the intrastate market.*" (Comm. Br., p. 2; emphasis added). In its brief the Commission no less than twenty-five times states or implies that the royalties to be paid to Williams under the settlement are "based on" or "tied to" the unregulated price of natural gas in the intrastate market. These contentions are contrary to the plain wording of the settlement agreement and completely misinterpret the intentions of the parties to the settlement. The error is indeed grave in that it forms virtually the entire basis for arguments urged by the Commission, relying on its interpretation of *Texaco Inc. v. FPC*, 417 U.S. 380 (1974).

The royalty to be paid to the lessor under the settlement agreement of June 18, 1975 is the higher of 78¢ (plus 1.5¢ per Mcf annual escalations commencing January 1, 1976) or 150% of the highest area or national rate authorized by the Commission, plus Btu and tax adjustment. The 78¢ represented 150% of the then effective national rate set by the Commission. The

150% figure was not arbitrarily arrived at by the parties; it represented the same percentage of the national rate that the Commission in a then pending rulemaking proposal sought to permit small producers to collect.[5]

Subsequent to execution of the settlement agreement, the Commission adopted Opinion No. 770-A, which increased the national rate from 52¢ to $1.42 per Mcf. In order to take into account the effect of the substantial rate increase, Williams agreed to modify the settlement agreement to provide the basis for payment of royalties after July 26, 1976 (the effective date of Opinion 770-A) will be the higher of 78¢ as escalated or *100%* of the highest area or national rate. The settlement as revised was patterned after and almost identical to a proposed settlement then pending before the Commission for approval between El Paso Natural Gas Company and royalty interest owners in West Texas. That settlement was subsequently approved by the Commission and declared to be "reasonable and proper and in the public interest in carrying out the provisions of the Natural Gas Act." *El Paso Natural Gas Co.*, Docket Nos. RP 72-105, *et al.* (Feb. 16, 1977), at 24.[6] The Commission's position here is inconsistent with its approval of the *El Paso* settlement.

5 Small Producer Regulation, Notice of Proposed Rulemaking, Docket No. R-393 (Sept. 9, 1974), 39 F.R. 33241 (1974). It appeared at the time that Williams would qualify as a small producer were it to sell gas in the interstate market.

6 The settlement agreement in the *El Paso* case provided for royalty to be paid on the basis of 40¢ per Mcf from June 1, 1974, to be redetermined each subsequent June 1 as 7¢ less than the highest base rate, adjusted for Btu, allowed by the Commission for gas produced from areas where El Paso's pipeline system in the lower 48 states is located.

If, as the Commission contends royalties payable to Williams under the settlement were tied to the free and unregulated intrastate market for gas, a substantially different result would obtain. The price of gas in the unregulated intrastate market in the South Louisiana area is substantially higher than the royalty rate that would be payable to Williams under the settlement. Based on information obtained by Williams through discovery in the state court litigation, Shell and Pennzoil were paying or receiving up to $1.40 per Mcf for gas sold in the intrastate market in the Gibson Field area through the date of settlement (June 1975). The market value claim of Williams for the period subsequent to June 1975 is substantially above the 1975 amounts.[7]

Contrary to the repeated assertions of the Commission, the royalty payable to Williams under the settlement agreement is not based on or tied to the unregulated intrastate market,[8] but is expressly tied to

7 In *Kingery v. Continental Oil Co.*, 434 F. Supp. 349, 351 (W.D. Tex. 1977), a federal district court held that the market price for gas in a field in West Texas, based on expert testimony, was $1.90 per Mcf in 1976 and $2.00 per Mcf in 1977. We anticipate from information obtained in discovery in the state court litigation that similar values can be substantiated in South Louisiana.

8 The Commission reasons that the settlement is "based on" the unregulated market because the settlement reflects a claim for royalties based on the unregulated market (Comm. Br., p. 14). This argument not only defies logic, but is factually inaccurate. Regardless of the nature of the claim, the settlement is based upon the regulated market. In any event, the Commission's description of the nature of the *claim* is inaccurate.

The Williams leases require the payment of royalties calculated at the market value of gas at the wellhead. Nothing in the leases requires that market value be determined solely by reference to the unregulated intrastate market. Market value is determined by the testimony of experts, who presumably take into account all relevant factors, including not only the prices in the intrastate gas market, but also the prices paid for equivalent commodities.

the highest area or national rate established by the Commission. If the settlement agreement were implemented today, it would call for payments of royalties equal to the maximum rate allowed by Commission Opinion No. 770-A rather than the higher intrastate price presently prevailing in South Louisiana.

The Commission further contends that upholding the decision of the Court of Appeals below would subject jurisdictional rates to "unpredictable fluctuations and escalations that are beyond the control of the Commission" (Comm. Br., p. 21). If royalties payable under the settlement were in fact based on or tied to the unregulated intrastate market, unpredictable fluctuations might be possible. But in the settlement presented to the Commission in this proceeding, the royalty rate is expressly tied to the Commission's own rate, so that the royalty cost shall be directly controlled by the Commission.

Thus, the entire basis for the Commission's reliance on *FPC v. Texaco Inc.* is absent. But there is even a more fundamental reason why the *Texaco* decision is inapplicable. The Court in *Texaco* held invalid a proposed Commission order that would exempt from regulation under the Natural Gas Act all gas sales made by small producers. The only exception to total deregulation of small producers was a provision in the order that refused to permit "tracking increases" by pipelines purchasing from small producers to the extent that rates charged by the small producer were "unreasonably high" considering appropriate comparisons with highest contract prices charged by large producers or the prevailing market price in the intrastate market. 45 FPC 454, 457 (1971).

The proposed order invalidated by the Court in *Texaco* would have exempted from regulation a group of producers who were admittedly subject to regulation by the Natural Gas Act. Landowners-lessors such as Williams, unlike small producers, are not subject to regulation under the Act. *Mobil Oil Corp. v. FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972). It is well established, and the Commission apparently concedes (Comm. Br., p. 37, n.22), that the payment of rent or royalties by the lessee to a landowner, in the form of a percentage of the value of the product extracted, is not a "sale" of that product by the lessor to the lessee. The rent or royalty paid to the landowner-lessor is a cost of exploration to the lessee, which if reasonably and prudently incurred should properly be passed on to the ultimate purchaser of the product. We submit that the record supports the reasonableness of the increase in royalty costs incurred by Pennzoil and Shell as a result of the settlement.

II. The Settlement Agreement Reflects A Reasonable Compromise Between The Producers And Royalty Owners Based On Known Litigation Risks; Accordingly, The Rate Increase Resulting From Passing Through The Additional Royalty Cost Is Reasonable.

The issue before this Court is whether the Commission has authority to adjust the rate of an independent

natural gas producer to reflect increased royalty costs resulting from the proposed settlement with the royalty owners, as it is now doing for pipeline companies regulated under the same statute. *El Paso Natural Gas Co., supra* note 6. This case does not involve a determination of the merits of the state court litigation. Thus, the issue of whether lessors under a market value lease are entitled to be paid royalties based on the market value for gas in excess of Commission price ceilings, or whether they are limited to price ceilings fixed by the Commission, is not before this Court.

The merits of the state court litigation are involved in this case only insofar as the litigation risks are involved in determining whether the settlement is reasonable. As pointed out by the Court of Appeals, the Commission has authority to consider the reasonableness of any costs incurred. *Pennzoil Producing Co. v. FPC,* 553 F.2d at 488. The Court of Appeals found that Shell and Pennzoil were put in a "bind" as a result of the state court litigation, and that they had a right to seek individualized relief from the Commission to relieve the bind. *Id.*

Although the royalty owners have a vital interest in the outcome of this proceeding, the nature of this proceeding has precluded their presence and representation. Because the position of the royalty owners is opposed by the Commission, Pennzoil and Shell, the only parties to this proceeding, there has not been presented to the Commission or the Court of Appeals a full assessment of the litigation risks to Pennzoil and Shell in the state court litigation. While the producers

have indicated that the proposed settlement is fair and reasonable, they are not in a position to show the strong position of Williams in the state court proceeding for fear that their statements might prejudice their cause in the state court. As a result, the Commission in its brief contends that Pennzoil and Shell cannot be assumed to be in a bind, and further that courts are divided on the "market value" issue (Comm. Br., p. 35). The Commission then repeats the unsupported speculation of the administrative law judge below that "[i]t is highly doubtful that Williams would prevail on its claim that 'market value' for basing royalty payments means a price in excess of the Commission established area and nationwide ceiling prices." *Id.* The Commission's attempt to discredit or discount the litigation risks that faced Pennzoil and Shell in June of 1975, and that face them now if the settlement is not approved, cannot be left unchallenged.

The settlement agreement reached by Pennzoil, Shell and Williams in June of 1975 resulted from extensive discovery and negotiations. Facts developed through discovery and the emerging case law interpreting market value clauses in leases weighed heavily in favor of Williams. Evidence developed through interrogatories, depositions and document production in the state court litigation do in fact support the following assertions of Williams:

1. The dedication of gas produced from the lands of Williams, Inc. in Gibson Field, Louisiana to interstate commerce resulted solely from the decision and actions of the lessees, Shell and Pennzoil, without seeking the advice and consent of the lessor, Williams, Inc.

2. There existed at the time of the dedication of the gas to interstate commerce a substantial intrastate market for the gas, the City of New Orleans, and gas produced from other nearby fields were directed by Pennzoil to this intrastate market, while the gas produced from Gibson Field was arbitrarily committed to a contract with Pennzoil's then affiliate, United Gas Pipe Line Co., for resale in the interstate market.

3. Between 1971 and the present, both Shell and Pennzoil have sold gas produced from lands of others in Gibson Field and adjacent gas fields in the intrastate market at substantially higher prices per Mcf than the rates used in calculating royalties paid to Williams.

The results of a judgment against Pennzoil and Shell in the state court litigation would be dire. The primary relief requested by Williams is lease cancellation, plus damages for the underpayment of royalties until the leases are released to Williams. Thus, the respondents could face a large money judgment and the loss of revenues from Gibson Field in the future. If the state court were to deny lease cancellation but award Williams damages to compensate for the difference between the market value of gas royalties and the royalties actually paid, Pennzoil and Shell would undoubtedly sustain a substantial loss from their operations in Gibson Field. Furthermore, under the Louisiana Mineral Code, the court may award as damages *double* the amount of royalties due, plus interest and attorneys' fees, regardless of the cause of the failure to pay royalties. La. R.S. 31:140 (1974).

Assessing litigation risks for settlement purposes involves applying the existing jurisprudence to the facts of the particular case. The Commission has not cited one case that actually supports its statement that the courts are divided on the interpretation of market value royalty clauses in leases. To the contrary, the overwhelming conclusion of federal and state courts is that gas royalties payable to lessors under market value royalty clauses are not subject to rate ceilings set by the Commission.

In *Denman v. J. M. Huber Corp.*, 251 F. Supp. 746 (N.D. Tex. 1964), lessors sued the lessee for the continuing breach of contractual obligations under royalty clauses of three leases, contending that the lessee refused to pay royalty gas at market price or market value but instead paid only the amount received from the pipeline company for the gas. The court held that the royalty owners were legally entitled to collect royalties from the lessee computed at the market value or market price in excess of the applicable effective rate under the Natural Gas Act pursuant to the rules and regulations of the Commission. On appeal, the Fifth Circuit Court of Appeals affirmed that portion of the district court's holding, but remanded the case and instructed the district court to refrain from fixing "market price" of gas pending an invocation by the parties of a ruling from the Commission as to its jurisdiction over rates to be paid for gas royalty. *J. M. Huber Corp. v. Denman*, 367 F.2d 104 (5th Cir. 1966). Thereafter, the royalty owners petitioned the Com-

mission for a declaratory order disclaiming jurisdiction. The case was consolidated with similar cases, and the Commission subsequently ruled that the royalty provisions of oil and gas leases constituted sales of natural gas for resale in interstate commerce, subject to the provisions of the Natural Gas Act. FPC Opinion No. 562, 42 FPC 164. On appeal, the Court of Appeals for the District of Columbia reversed the Commission ruling and specifically held that royalty provisions in leases entitling royalty owners to a percentage interest in gas sold did not constitute sales of natural gas in interstate commerce subject to the Natural Gas Act and, accordingly, royalty owners were not subject to Commission regulation. *Mobil Oil Corp. v. FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972). Further the court stated:

> To avoid any misunderstanding we interject that we have not been made uneasy by the contentions the producers have presented to us, *for we see no theoretical impediment to producers' being held on the basis of a contract to a royalty payment related to a base higher than the producers' filed rate* . . . . In any event, we are not persuaded that the maintenance in either state or federal courts of contract (lease) controversies between royalty owners and lessees will undercut the Federal regulatory system. 463 F.2d at 264-65 (emphasis added).

Other federal decisions have recognized that the royalty obligations of producers are not governed by the Commission but rather by state law. *Placid Oil Co. v. FPC*, 483 F.2d 880, 911 (5th Cir. 1973); *In re Other Southwest Area Rate Case* (OSWAI), 484 F.2d 469, 471, n.3 (5th Cir. 1973).

In *Foster v. Atlantic Refining Co.*, 329 F.2d 485 (5th Cir. 1964), the lessee in 1950 entered into a twenty-year gas sales contract calling for a price that was admittedly the market price at that time. Subsequently the prevailing price in the field rose substantially above the escalated price provided in the gas sales contract. The Fifth Circuit rejected the argument that the market price for determining royalty under a lease was the market value of gas at the time the lessee entered into the long-term gas contract.

> The inability of Atlantic to make its gas sales contract with escalation provisions is beside the point. The obligation of Atlantic to pay royalties is fixed and unambiguous. It made the gas sales contract with full knowledge of this obligation and did nothing to protect itself against increases in price. The fact that its purchaser would not agree to pay the market price prevailing at the time of the delivery does not destroy the lease obligation . . . When it made the gas sales contract, Atlantic took the calculated risk of that contract producing royalties satisfactory to the lease terms. The fact that increases in market prices have made the lease obligations financially burdensome is no defense.
>
> * * *
>
> . . . The lease calls for royalty based on the market price prevailing for the field where produced when run. The fact that the ascer-

tainment of future market price may be troublesome or that the royalty provisions are improvident and result in a financial loss to Atlantic "is not a web of the court's weaving." Atlantic cannot expect the court to rewrite the lease to Atlantic's satisfaction. 329 F.2d at 489-90 (quoting *Phillips Pet. Co. v. Bynum*, 155 F.2d 196, 198 (5th Cir.), *cert. denied*, 329 U.S. 714 (1946)).

In *Texas Oil & Gas Corp. v. Vela*, 405 S.W.2d 68 (Tex. Civ. App. 1966), *reformed*, 429 S.W.2d 866 (Tex. 1968), the lessee urged that the lessor should be bound by the market value of gas existing at the time the lessee committed the gas to a sales contract. The court found persuasive the holding in *Foster* that the lessors were not parties to the gas sales contract and the terms thereof did not change the lessee's obligation to pay the market price of the gas. The court stated:

> It is elemental contract law that since the lessor is not a party to the gas purchase contract entered into between the lessee and a third party, he is not bound by the terms of same, if they are in conflict with lessee's obligation under the lease . . . .
>
> In our opinion the proper rule is that the price paid under a gas purchase contract entered into between lessee and a third party is not necessarily the "market price" as provided for in the lease. 405 S.W.2d at 74.

The court noted its interpretation of *Foster:*

> It was held in *Foster* that since the lessors were not parties to the gas sales contract, the terms of the contract did not change the lessee's obligation under the lease to pay the "market price." This obligation was fixed and unambiguous, and lessee was required to carry out same, however troublesome to ascertain or financially burdensome. 405 S.W.2d at 73.

On appeal to the Texas Supreme Court, that court expressed general agreement with the conclusion of *Foster* that even though the lease obligations may prove financially burdensome to a lessee who has made a long-term contract without protecting itself against increases in market prices, the lessee was bound to pay market price. 429 S.W.2d at 871.

In *Vela*, the lessors executed their original lease in the year 1933, only one year before Williams granted to Shell the primary lease in question in this case. The Natural Gas Act of 1938 was several years from enactment and the *Phillips* decision of the United States Supreme Court upholding the jurisdiction of the Commission was then two decades away. In *Vela*, natural gas was selling for only 2.3 cents per Mcf at the time of execution of the lease. The court ruled that the lessees were bound to pay the then existing market price of 13 cents per Mcf. The court quoted from *Foster:*

> When it made the gas sales contract, Atlantic [the lessee] took the calculated risk of that

> contract producing royalties satisfactory to the lease terms. The fact that increases in market prices have made the lease obligations financially burdensome is no defense. 429 S.W.2d at 871 (quoting *Foster*, 329 F.2d at 489).

The position of Williams in the state court litigation has been significantly enhanced by the cases in this area decided subsequent to the 1975 settlement. In *Kingery v. Continental Oil Company*, 434 F.Supp. 349 (W.D. Tex. 1977), appeal docketed, involving a 1944 market value lease, the court relied on *Vela, Foster, Huber* and *Mobil* to hold that gas royalties based on market value would be determined at the time the gas was sold and not at the time the lessee committed the gas to a long-term contract, and that the market value of gas was properly determined by evidence of specific sales of gas and contract negotiations for the sale of gas in the immediate vicinity of the lease, unfettered by rate ceilings fixed by the Commission.

> Collection of royalties at a rate in excess of that established by the Federal Power Commission does not subvert the purpose of the Natural Gas Act nor undercut the Federal Regulatory System. 434 F. Supp. at 355.

The court in *Kingery* found the market value of gas, based on expert testimony, to be as follows:

A. For the year 1972, \$.28/mcf.
B. For the year 1973, \$.55/mcf.
C. For the year 1974, \$1.25/mcf.
D. For the year 1975, \$1.85/mcf.

E. For the year 1976, \$1.90/mcf.
F. For the year 1977, \$2.00/mcf.

434 F. Supp. at 351.

The Supreme Court of Kansas has reached a similar result in *Lightcap v. Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1, *cert. denied*, 434 U.S. 876 (1977), petition for rehearing pending. The court in *Lightcap* held that "the existence of federal regulation over the rates which a gas producer may receive is no obstacle to the fixing of a higher rate as the 'market value' of the gas it sells for the purpose of computing royalties." 562 P.2d at 8. With respect to the claim by the lessee that the maximum rate imposed by the Commission puts a ceiling on the royalty cost the lessee may incur, the Kansas Supreme Court stated:

> [T]he process begins at the other end. The royalties to be paid are first to be determined under state law, based on the terms of the lease. The royalties so determined then become a component cost, to be considered by the FPC in determining the rates it will permit Mobil to charge. In this respect royalties paid are costs to a gas producer in the same way as fuel bills are costs to an electric utility. Neither cost is directly under the jurisdiction of the utilities regulatory agency, but both are considered in the agency's rate making function. *Id.*

In the face of the overwhelming authority to the contrary, the Commission claims that the courts are "divided" on the issue and quotes the administrative

law judge's opinion that it is "doubtful" that Williams would prevail on its claim (Comm. Br., p. 35). As authority for the division of authority the Commission cites *Mobil Oil Corp. v. FPC, supra*, and *Whitehall Oil Co. v. Boagni*, 255 La. 67, 229 So.2d 702 (1969). The *Mobil* case specifically held that the Commission's rate-making jurisdiction does not extend to the landowner's lease or its royalty payments, and stated that it was not persuaded that contract controversies between royalty owners and lessees would undercut the federal regulatory system. 463 F.2d at 263, 265. The court did speculate in dictum that a lessor's claim for royalties might be considered by a court to run counter to the intention of the parties, but added:

> The question might be obviated in a particular case if the court discerned an intrastate market, capable of absorbing the volumes involved, not subject to any Federal ceiling. 463 F.2d at 265, n.24.

Clearly under the present dispute between Williams and the appellees, with a intrastate market available, the court's dictum is not applicable.

The Commission cites *Whitehall Oil Company v. Boagni* as an indication of the view of the Louisiana Supreme Court that "the 'market value' of gas sold for resale in interstate commerce can be established only by reference to the just and reasonable rate set by the Commission." (Comm. Br., p. 5, n.4). Quite to the contrary, the *Whitehall* case did not involve the issue of market value royalties, but whether a lessor was obligated under the lease to refund to the lessee

amounts that the lessee had to refund to its pipeline purchaser pursuant to an order of the Commission. Under the lease in question, the lessee was *obligated* to sell the lessor's gas *for the same price and under the same terms* as it sold its own. The Commission's argument that the Louisiana Supreme Court equated market value of gas to the Commission's regulated rates, under the facts of the *Whitehall* case, is totally without basis.

The real issue for the Commission, however, was not a determination of whether Pennzoil and Shell or Williams would prevail in the litigation. Rather, the Commission should have focused only on whether, considering all circumstances, Pennzoil and Shell acted prudently and reasonably in executing the settlement. The Commission has since stated this to be the proper focus of its consideration. *El Paso Natural Gas Co., supra*. The record below establishes beyond doubt that Pennzoil and Shell acted reasonably and prudently in executing the settlement agreement, and no one has challenged that fact. Had the Commission then considered the matter as it has subsequently in *El Paso* acknowledged it should, it would have granted the relief requested.

In summary, Shell and Pennzoil were indeed placed and remain in a difficult bind in the state court litigation. The settlement reached with Williams was prudent on the part of Pennzoil and Shell, considering the litigation risks facing them. The contention by the Commission that the respondents were not in a bind, or that the settlement was not reasonable, or that the increased rate resulting from the settlement was not

reasonable, is contrary to the record and did not form the basis of the Commission's decision.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

CAMPBELL C. HUTCHINSON
ANTHONY M. DiLEO
Stone, Pigman, Walther,
Wittmann & Hutchinson
1000 Whitney Building
New Orleans, Louisiana 70130
Telephone: (504) 581-3200

Counsel for Williams, Inc., et al., Amici Curiae

CERTIFICATE OF SERVICE

I hereby certify that on the ____ day of October, 1978, three copies of the foregoing brief of Williams, Inc., et al, Amici Curiae, were served upon the following counsel of record by placing them in the United States mail, postage prepaid, addressed to:

JERON L. STEVENS, Esquire
STEPHEN M. HACKERMAN, Esquire
Baker and Botts

3000 One Shell Plaza
Houston, Texas 77002

THOMAS G. JOHNSON, Esquire
JOSEPH H. FIELDS, Esquire
Shell Oil Company
P. O. Box 2463
Houston, Texas 77001

WILLIAM B. CASSIN, Esquire
Executive Vice President &
General Counsel
PHILLIP D. ENDOM, Esquire
Vice President &
Associate General Counsel
LEE M. HUBER, Esquire
700 Milam
P. O. Box 1478
Houston, Texas 77002

WADE H. McCREE, JR.
Solicitor General
Office of the Solicitor General
Department of Justice
Washington, D.C. 20530

DONALD R. ARNETT, Esquire
Austin and Arnett
1938 Bank of the Southwest Building
Houston, Texas 77002

I hereby certify that all parties required to be served have been served.